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No. 91-1135

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
October Term, 1991

NEWARK MORNING LEDGER CO.,
as successor to the Herald Company,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court of Appeals for the Third Circuit

JOINT BRIEF OF AMICI CURIAE PENNSYLVANIA PETROLEUM ASSOCIATION AND FUEL MERCHANTS ASSOCIATION OF NEW JERSEY IN SUPPORT OF PETITION

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JOINT BRIEF OF AMICI CURIAE PENNSYLVANIA PETROLEUM ASSOCIATION AND FUEL MERCHANTS ASSOCIATION OF NEW JERSEY IN SUPPORT OF PETITION

This brief is submitted in support of Appellant Newark Morning Ledger Co's. Petition for a Writ of Certiorari to review the Third Circuit Court of Appeals decision (945 F.2d 555 (3rd Cir. 1991)) reversing the decision of the United States District Court for the District of New Jersey (734 F.Supp. 176 (D.N.J. 1990)) in favor of Appellant.

INTERESTS OF AMICI CURIAE*

The opinion of the Third Circuit Court of Appeals presents issues of major significance to petroleum jobbers and dealers within the jurisdiction of the Third Circuit.

The Pennsylvania Petroleum Association ("PPA") and the Fuel Merchants Association of New Jersey ("FMANJ") are both regional trade associations whose active members are not producers, refiners or manufacturers of petroleum products, but independent business entities each employing an average of more than 10 persons. PPA has 580 active members and 333 associate members and FMANJ has 480 active members. All of the members of FMANJ and most of the active members of PPA are engaged in the sale of home heating oil to residential consumers.

In almost every case the Customer List of a retail fuel oil dealer is its single most valuable asset. For the past twenty years it has been universally recognized that the purchaser of such a Customer List could amortize its value over its useful life - the issues of value and useful life being factual issues dependent on the particular facts and circumstances of each transaction. The decision of the Third Circuit in the instant case disregards almost twenty years of judicial precedent as well as the stated position of the Internal Revenue Service as set forth in Rev. Rule 74-456.

The Circuit Court's decision raises the spectre that depreciation deductions heretofore allowed for two decades to purchasers of retail fuel oil customer lists and similar intangible assets acquired in the purchase of a going concern may be denied *as a matter of law* thus eliminating the facts and circumstances test established by both judicial precedent and the Internal Revenue Service's

*Written consents as required by Rule 37 of the Supreme Court Rules for the filing of this brief were obtained and are on file in the Clerk's office. The decision below is reported at 945 F.2d 555.

own regulations and rulings. The effect will be devastating to the petroleum dealers represented by PPA and FMANJ as it will result in a substantial decrease in the value of each member's Customer List by reason of the fact that a purchaser may no longer be permitted to deduct the cost of acquiring the same. The tax Reform Act of 1986 has already dealt a servere blow to sellers of a retail fuel oil business (as well as other small businesses) by eliminating the "General Utilities" doctrine formerly embodied in I.R.C. §337 thus subjecting them to a double tax - at both the corporate and shareholder levels whereas the former tax could previously have been provided by compliance with I.R.C. §337.

If this decision is permitted to stand, the small businesses which comprise the active membership of PPA and FMANJ may be rendered virtually unsaleable with the result that the substantial tax revenues currently generated by such transactions may evaporate.

ARGUMENT

I

THE THIRD CIRCUIT'S DECISION DISREGARDS ALMOST TWENTY YEARS OF JUDICIAL PRECEDENT AS WELL AS THE INTERNAL REVENUE SERVICE'S OWN INTERPRETATION REGARDING DEPRECIATION OF INTANGIBLE ASSSETS AND REQUIRES REVIEW BY THIS COURT.

In addition to those reasons for granting ceriorari set forth in Newark Morning Ledger Co's. Petition, which are hereby adopted, the Third Circuit's opinion is, as a practical matter, a reincarnation of the "Mass Asset" rule which was interred in *Houston Chronicle Publishing Co. v. U.S.*, 481 F.2d 1240 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974).

Prior to 1974 the Internal Revenue Service took the position that intangible assets in the nature of customer lists were not depreciable and the majority of the court decisions prior to 1970 favored the government, although the courts generally characterized the issue as factual, not legal. *Thrifticheck Service Corporation v. Commissioner*, 287 F.2d 1 (2d Cir. 1961); *Klein v. Commissioner*, 372 F. 2d 161 (2d Cir. 1966).

However, starting with the decision of the Ninth Circuit Court of Appeals in *Commissioner v. Seaboard Finance Co.*, 367 F.2d 646 (9th Cir. 1966), the courts, and later the Internal Revenue Service, began to recognize that in the context of modern business "...when lists are bartered and sold as discrete vendible assets",[1] amortizability of intangible assets is a factual question to be determined in each case and further liberalized the evidentiary burden on the taxpayers required to sustain the deduction. See also *Manahattan Company of Virginia*, 50 T.C.78 (1968); Gov't's appeal to CA-4 dismissed (nolle pros.), 12/9/68; Gov't's appeal to CA-DC dismissed (nolle pros.) 1/27/69.

Houston Chronicle Publishing Co. v. U.S., 481 F. 2d 1240 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974) involved newspaper subscription lists purchased by Houston Chronicle from a competitor which was ceasing business. No allocation of the total purchase price was made prior to the closing of the transaction which also involved the acquisition of the printing plant, equipment, inventory and other tangible assets of the competitor as well as a 10 year covenant not to compete. After the sale, the taxpayer engaged an appraiser to evalute the acquired assets and the subscription list was valued at $71,200.

The Court upheld the deduction emphasizing that the

1. *Houston Chronicle Publishing Co. v. U.S.*, 485 F2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974).

question of amoritizability is exclusively an issue of fact, stating as follows:

> "Judicial tolerance compels us to say that many jurists and scholars could diagnose tax non-depreciability in the muscles and tendons of list transactions. We reject, however, the establishment of a per se rule and a monolithic "mass asset" theory that would amalgamate all subscriptions lists with goodwill.
>
> "Our view -- that amortizability for tax purposes must turn on factual bases -- is more in accord with the realities of modern business technology in a day when lists are bartered and sold as discrete vendible assets. Extreme exactitude in ascertaining the duration of an asset is a paradigm that the law does not demand. All that the law and regulations require is reasonable accuracy in forecasting the asset's useful life." (481 F.2d at pp 1253-4)

In arriving at its conclusion, the Court's opinion distinguishes the earlier "goodwill" and "mass asset" cases (including *Klein, supra; Thrifticheck Service Corporation v. Commissioner, supra;* and *Anchor Cleaning Service, Inc. v. Commissioner*, 22 T.C. 1029 (1954) as involving evidentiary failure on the part of the taxpayer.

The opinion acknowledges that no depreciation deduction is allowable with respect to an intangible asset such as goodwill which does not have a limited useful life and further recognizes that the "only question litigated in recent years ... is whether a particular asset is 'goodwill' ". The Court then reviewed the definition of "goodwill" for tax purposes as follows:

" '(T)he nature of goodwill...is the expectancy that 'the old customers will resort to the old place.'...

" 'This Court has held that...goodwill is acquired by the purchaser of a going concern where the 'transfer enables the purchaser to step into the shoes of the seller.' We have also said that goodwill is transferred where, as here, the buyer continues the seller's business uninterrupted, using primarily the seller's employees, and utilizing the seller's name." [citations omitted] (Emphasis supplied) (481 F.2d at p. 1247).

The Court also recognized that the threshold question in determining the amortizability of a customer list (or any intangible asset) is whether that asset can be shown to have a limited useful life in the purchaser's business. If a limited useful life is established, then the asset cannot be goodwill which, by definition, continues indefinitely.

In 1974, in response to the taxpayer victories in the foregoing cases and others (including *Holden Fuel Oil Co. v. Commissioner*, 479 F.2d 613 (6th Cir. 1973), discussed infra) the Internal Revenue Service conceded in Rev. Rul. 74-456, 1974-2 C.B. 65, that customer lists, insurance expirations and similar intangible assets are not, as a matter of law, indistinguishable from goodwill; rather the question of amortizability is recognized to be a factual question. Rev. Rul. 74-456 reads in part:

"Generally, customer and subscription lists, location contracts, insurance expirations, etc., represent the customer structure of a business, their value lasting until an indeterminate time in the future. These lists, contracts, insurance expirations, etc., are in the nature of goodwill or otherwise, have indeterminable lives and, therefore, are not subject to depreciation. [citations omitted]

"However, if in an unusual case the asset or a portion thereof does not possess the characteristics of goodwill, is susceptible of valuation, and is of use to the taxpayer in its trade or business for only a limited period of time, a depreciation deduction is allowable. See Manhattan Company of Virginia, 50 T.C. 78 (1968) acq., page 3, in which the court determined that the trial record contained sufficient facts to permit an allocation of the purchase price of customer lists between depreciable and nondepreciable portions.

"*Rev. Rul. 65-175 and Rev. Rul. 65-180 are modified to remove any implication that customer and subscription lists, location contracts, insurance expirations, etc., are, as a matter of law, indistinguishable from goodwill possessing no determinable useful life. The depreciability of assets of this nature is a factual question, the determination of which rests on whether the taxpayer establishes that the assets (1) have an ascertainable value separate and distinct from goodwill, and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy.* No deduction is allowable merely because a basis has been estimated and the asset has a limited useful life in the unsupported view of the taxpayer. See Houston Chronicle Publishing Co. v. United States, 73-2 U.S.T.C. 81,697 (5th Cir. 1973); Skilken v. Commissioner, 420 F.2d 266 (6th Cir. 1969) (Emphasis supplied)

Since 1974 and until the Third Circuit decision in this case the Courts have been surprisingly consistent in upholding amortization deductions under I.R.C. § 167(a) for intangi-

ble assets in the nature of customer lists. See *Richard S. Miller & Sons, Inc. v. U.S.*, 557 F.2d 446 (Ct. Cls. 1976); *L.A. Central Animal Hospital, Inc. v. Commissioner*, 68 T.C. 269 (1977) (upholding amortization of Customer List despite (i) purchase of business as a "going concern"; (ii) continued use of Seller's name; and (iii) continued use of Seller's business location); *Panichi v. United States*, 834 F.2d 300 (2nd Cir. 1987); *Donrey, Inc. v. United States*, 809 F.2d 534 (8th Cir. 1987); *McCarthy v. United States*, 807 F.2d 1306 (6th Cir. 1986); *Ralph W. Fullerton Co. v. United States*, 550 F.2d 548 (9th Cir. 1977); *Citizens and Southern Corporation and Subsidiaries v. Commissioner*, 91 T.C. 463 (1988), aff'd per curiam, 900 F.2d 266 (11th Cir. 1990).

From an examination of these cases, Rev. Rul 74-456 and Regs. § 1.167(a)-3, it is clear that (i) a Customer List is not, as a matter of law, indistinguishable from goodwill; (ii) the question of amortizability is a factual issue; and (iii) a Customer List may be amortized if the taxpayer establishes that the asset has (a) a limited useful life, the duration of which can be ascertained with reasonable accuracy, and (b) an ascertainable value separate and apart from goodwill. Once it has been established that such an asset has a limited useful life, it cannot be equated with goodwill which, by definition, continues indefinitely.

II

UNLESS REMEDIED BY THIS COURT, THE THIRD CIRCUIT'S DECISION WILL HAVE A SIGNIFICANT ADVERSE EFFECT ON THE VALUE OF A FUEL OIL CUSTOMER LIST.

As stated above, the single most valuable asset of a retail fuel oil dealer is its Customer List which the decided

cases have consistently held to be depreciable wasting assets.

In *Holden Fuel Oil Company v. Commissioner*, 479 F. 2d 613 (6th Cir. 1973), the Court of Appeals upheld the amortizability of a retail fuel oil Customer List. After stating the obvious - that the cost of an intangible asset may be amortized if it can be established "that the asset is of use in a business for only a limited period of time which can be estimated with reasonable accuracy," the Court firmly rejected the government's contention that the lists were intangible assets in the nature of goodwill.

> "The appellant's first contention is that the lists are not amortizable because they are intangible assets in the nature of goodwill, and have no reasonably ascertainable useful lives. The appellant argues that the purchaser obtains not only a list of names, but also obtains an established clientele and an ongoing business relationship, the value of which fluctuates as customers are dropped or acquired, and that therefore, the lists have a business usefulness of a limited time which is not reasonably ascertainable.
>
> "We disagree. The appellee's only guaranteed acquisition from this contractual arrangement was the list of names. Although Gulf did send a form letter to all of the customers on the list informing them that the appellee was now distributing Gulf Oil in the area and solicited their business, these customers were not obligated to purchase fuel oil from the appellee because there had been no contract between Gulf and its customers. The list contained over 5,000 potential customers, but only 3,007 accounts were sold fuel oil by the appellee during the fiscal year ended May 31, 1962. On May 31, 1968, only 1,577 customers were still purchasing oil from the appellee.

"*Since the appellee initially acquired a list of 5,199 names, and was supplying only 1,577 of them with oil as of May 31, 1968, the lists were demonstrably wasting assets. Furthermore, evidence was introduced to show that the appellee would lose approximately 10% of its customers each year.* Trade indicators calculated the life of a fuel oil account to be from 8 to 10 years. Furthermore, the parties stipulated that the appellee lost approximately 50% of its total fuel oil deliveries initially acquired from the list in a six year period following May 31, 1962, the year that the contract price was determined. Upon this evidence, the Tax Court determined that the list acquired by the appellee had a limited life and that life was reasonably ascertainable. This was in accordance with the regulations which provide that an intangible asset may be the subject of a depreciation allowance if it is known from experience or other factors to be of use in the business for only a limited period, the length of which can be estimated with reasonable accuracy. Treas. Reg.§ 1.167(a)-3" (Emphasis supplied).

The recent case of *ABCO Oil Corp. v. Commissioner*, 46 T.C.M. (CCH) 343 (1990) involved the issue of whether the purchaser of two retail fuel oil operations in Pennsylvania could depreciate the costs attributable to the Customer Lists acquired together with other assets, including "Goodwill." In upholding the depreciation deduction, the Court stated that:

"A customer list is an intangible asset which may be amortized if it has a useful business life of limited duration, the length of which can be estimated with reasonable accuracy. Goodwill, on the other hand, does not have a limited useful business life and thus is not amortizable. § 1.167(a)-3, Income Tax Regs....

"The determination as to whether a customer list has value independent of good will and if so, the amount of that value, is a question of fact. The record herein clearly supports a finding, and we so find, that both the Panczak and Flad customer lists have independent value. Indeed, respondent's expert conceded such on the stand....

"...[W]e believe petitioner, to a limited extent, desired to preserve Panczak and Flad customer continuity. It would be naive for us to believe that petitioner did not attempt to preserve the patronage of the former customers of Panczak and Flad when it notified the former customers of Panczak and Flad that it had acquired the latter's businesses and when it kept the Panczak and Flad phone numbers and listed them in the phone book. These actions obviously were taken to maintain for petitioner the patronage of the Panczak and Flad customers - and continued customer patronage is the essence of goodwill. Accordingly, we believe a portion of the amounts putatively paid for the customer lists must be allocated to goodwill.

"Although a specific allocation in the purchase agreement, or in the negotiations leading thereto, may be the best evidence in determining the cost basis of an asset, if such evidence is not available, then we must make such an allocation on other available evidence. As is frequently the case, here the record is less than desirable. Nonetheless, we are satisfied that we can make an allocation between the customer lists and goodwill. Based on the record before us, we conclude that 25 percent of the stated amount for the customer lists is properly allocable to goodwill and the remaining 75 percent of the stated amount is properly allocable to the customer lists....

"Having ascertained the cost bases for the customer lists, we now turn to whether such lists have a limited business life. We find that they do.

"In determining whether an intangible, such as a customer list, has a limited business life, we consider a number of factors, including: testimony of expert witnesses, experience in the industry, testimony of officers, relationship of geographic area and the customers involved, turnover of customers (both before and after the acquisition of the list), and other pertinent factors...

"...Accordingly, we find the the Panczak and Flad customer lists each had a limited useful life of five years." [Citations omitted]

If the Third Circuit's decision in the instant case is permitted to stand, the value of all businesses having significant customer based intangible assets, including the members of PPA and FMANJ, will suffer a significant decrease. Furthermore, as a result of conflict among the circuits, the value of such businesses located within the jurisdiction of the Third Circuit may suffer such a loss while similar businesses elsewhere remain unaffected.

III

THE THIRD CIRCUIT'S DECISION IS IN CONFLICT WITH OTHER CIRCUITS, UNDERMINING THE UNIFORM AND FAIR ADMINISTRATION OF FEDERAL TAXATION

The Third Circuit's opinion that a customer based intangible asset acquired in conjunction with an underlying business as a going concern is not depreciable *as a matter*

of law is a clear departure from prior case law and disregards both the governing statute and regulations and the Internal Revenue Service's own interpretation as expressed in Rev. Rul. 74-456. As indicated above, since the decision in *Houston Chronicle, supra,* the issue of depreciability has uniformly been held to be a question of fact determined by reference to whether the particular intangible asset is shown to have (i) an ascertainable value separate and apart from goodwill and (ii) a limited useful life, the duration of which can be ascertained with reasonable accuracy. Accordingly, all customer based intangible assets shown to have a limited life and ascertainable value have been held depreciable.

The Third Circuit has ignored this precedent and is in direct conflict with decisions by the Fifth, Sixth, Seventh, Eighth, Ninth and Eleventh Federal Circuits as well as the U.S. Tax Court. (See petitioner's petition, pp. 14-15; *Houston Chronicle, supra* (5th Cir.); *Holden Fuel, supra,* (6th Cir.)). The Third Circuit decision thus creates an irreconcilable conflict among the circuits.

It should also be noted that the Third Circuit drew a distinction between contractually based and terminable-at-will customer relationships holding that if the customers were contractually obligated for a period of time, the purchaser could depreciate the value of the list over that time period. In the petroleum industry, many customers have service contracts which usually are for a term of one year. In the case of publication subscription lists, customers often contractually subscribe for a fixed period. One can only imagine the reaction of the Internal Revenue Service to any attempt by a purchaser of contractually bound customer based intangibles to depreciate the value of that asset over the term of the contract (a much shorter period than that currently required).

CONCLUSION

For the reasons set forth above, the Pennsylvania Petroleum Association and the Fuel Merchants Association of New Jersey respectfully request that Newark Morning Ledger Co.'s Petition for a Writ of Certiorari be granted.

Respectfully submitted,

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